

EXPERT'S CORNER

When Should You Register?

A guide for when “tweeners” should register with the SEC

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SHOULD AN INVESTMENT advisor with \$30 million of “assets under management” register with the SEC? It depends on whether the advisor has “qualifying” assets under management.

While there has been talk about raising the assets under management threshold for SEC registration, the Advisers Act currently sets the threshold amount at \$25 million, but provides a \$5 million “window” which permits an advisory firm with \$25 million to defer registering with the SEC until it reaches \$30 million in assets under management. Thus, an advisor with between \$25 million and \$30 million in “qualifying” assets under management is permitted, but not required, to register with the SEC.

Whether an advisor has qualifying assets under management for SEC registration purposes will be dependent upon a “yes” response to a two-part test:

Does the advisory account qualify as a “securities portfolio”? and

Does the advisor provide “continuous and regular supervisory or management services” with respect to a “securities portfolio”?

PORTFOLIO DEFINITION

The SEC defines a “securities portfolio” as a portfolio in which at least 50% of the total value consists of securities, cash, and cash equivalents. If the account meets the 50% test, the advisor may include the value of the entire portfolio for “assets under management” purposes. An advisor may also include securities portfolios for which the advisor does not receive compensation for its services.

However, reaching the \$25 million or \$30 million threshold is only one part of the determination. The second, and most often overlooked (and misunderstood) determination is if the advisor provides

“continuous and regular supervision or management services” (i.e., the advisor has discretionary authority or has ongoing responsibility to recommend and arrange purchases and sales of securities for a client) for the “securities portfolio.”

Generally, advisory accounts that are actively managed by an investment advisor on a discretionary basis qualify for SEC registration purposes. But, what about non-discretionary advisors? Do advisors that allocate assets among separate account managers provide “continuous and regular supervision or management services”? Fortunately, the SEC has provided guidance, together with some specific examples, as to whether an advisor provides continuous and regular supervisory or management services with respect to its investment advisory services, and correspondingly has qualifying assets for SEC registration purposes. Specifically:

1) *Non-Discretionary Qualifying Assets:*

An advisor does not have discretionary authority over the account, but has ongoing responsibility to select or make recommendations, based upon the needs of the client, as to specific securities or other investments the account may purchase or sell and, if such recommendations are accepted by the client, the advisor is responsible for arranging or effecting the purchase or sale;

2) *Separate Account Manager Assets May Qualify:* Advisors that allocate assets among other managers (a “manager of managers”), but only if the advisor has discretionary authority to hire and fire managers and reallocate assets among them; and

3) *Assets Most Likely Do Not Qualify:* The advisor provides “qualifying” non-discretionary advisory services, but only provides advice on an intermittent or periodic basis “(such as upon client request, in response

to a market event or on a specific date (e.g., the account is reviewed and adjusted quarterly).” Thus, a non-discretionary advisor that reviews and/or reallocates client assets only periodically (e.g., quarterly), will, under the SEC examples, most likely not meet the “continuous and regular supervision or management services” test.

THE SEPARATE ACCOUNT ISSUE

Why is this important? It has a bearing as to whether an advisor should be/remain with the SEC or be state registered. Many SEC registered advisors may learn during an SEC exam that they do not have a sufficient amount of qualifying assets under management to remain SEC registered. Thus, an SEC advisor who has transitioned a substantial portion of its assets to separate account managers should make sure that either: (1) it retains discretionary authority to hire or fire the separate account managers without first obtaining client consent; or (2) it has retained at least \$25 million of qualifying assets under its management (i.e., assets for which it provides “continuous and regular supervision or management services”).

Conversely, based upon SEC definitions and examples, a non-discretionary state registered investment advisor does not need to transition to SEC registration solely because it advises on \$30 million or more of assets. Rather, it will depend on the manner in which the non-discretionary advisor provides services to its clients. If a state registered investment advisor having more than \$30 million in qualifying “securities portfolios” wants to remain as a state registered investment advisor, that non-discretionary state advisor, if true, should make clear on its written disclosure statement (and in its

written advisory agreement) that it does not provide “continuous and regular supervision or management services,” and that absent mitigating circumstances, it reviews accounts no more frequently than quarterly, regardless of whether the advisor is paid an ongoing fee based upon assets under management.

Why would a state-registered advisor want to remain state registered even if it has more than \$30 million of assets consisting of “securities portfolios?” For most who do so, it is because they do not currently provide “continuous and regular supervision or management services” and the vast majority of their clients reside in one specific state, and they have relatively few clients in other states that would require additional state registrations. (i.e., generally more than five clients in a state). For other state advisors, there is a perception (right or wrong) that there is much less regulatory scrutiny and/or compliance oversight/responsibility required at the state level.

THE CAVEAT

The understanding and review of the above criteria has been uneven. Some states have been referring advisors with more than \$30 million under management to the SEC, without first ascertaining whether the assets “qualify” for SEC registration specific purposes. Moreover, the SEC, absent clear disclosure by the advisor to the contrary, is sometimes disregarding its own guidelines, and encouraging or requiring state advisors who do not appear to provide “continuous and regular supervision or management services” to transition to SEC registration exclusively based upon the dollar amount of “assets under management.” That makes it all the more important for a non-discretionary advisor desiring to maintain state registration status to make clear on its written disclosure statement that it does not provide “continuous and regular supervision or management services,” and that absent mitigating circumstances it reviews accounts no more frequently than quarterly.

As an advisor increases assets under management or changes the manner in which it manages those assets (i.e., transitions to separate account managers), it should be mindful as to whether the increase or change will have an impact on its state /SEC registration status. **IA**

THE TAKEAWAY

- In deciding whether to register with the SEC, carefully count your firm’s “qualifying” AUM
- Determine whether you provide continuous and regular supervisory or management services
- The understanding and review of the AUM and supervision criteria has recently been uneven

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